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SIPDIS

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TAGS: ENRG EPET ETRD ETTC IT
SUBJECT: ENI UPDATE: ITALY'S ENERGY GIANT LOOKING BOTH INWARD AND OUTWARD

REF: ALMATY 2071

Classified By: Economic Minister-Counselor Scott Kilner for reasons 1.5 (b and d)

¶1. (SBU) Summary: ENI, Italy's dominant energy conglomerate, is expanding into foreign markets, while consolidating its position at home. Its significant presence in the Middle East and Central Asia increasingly is complemented by expansion within Europe, including recent acquisitions in Spain and Scandinavia. Domestically, ENI,s acquisition of shares of Italgas
(Italy,s largest natural gas distributor) allows it to consolidate its position in anticipation of continued liberalization under both Italian and EU directives. End Summary.

¶2. (SBU) Over the last year, ENI, Italy,s dominant energy conglomerate, has continued its expansion into markets outside Italy, while simultaneously consolidating its position in the Italian market. ENI executives, from President Roberto Poli on down, tell us of the company,s satisfaction with the steady, measured pace of its expansion within Europe. They are pleased with ENI,s operations in the Caspian Basin, especially the completion of the Blue Stream gas pipeline from Russia to Turkey and the company,s significant presence in both the gas and oil sectors of Kazakhstan.

Caspian Basin - Kazakhstan Up, Azerbaijan Down
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¶3. (C) In a meeting with Ecmin earlier this year, Poli pointed to Kazakhstan as the keystone of the company,s Caspian operations. ENI,s role (through Agip KCO) as single operator of the potentially enormous Kashagan oilfield is clearly a point of pride for the company -- so much so that ENI was quick to complain to us last summer when it felt its operator status was being threatened by consortium partner ExxonMobil. (Though that dispute's reported origins stem from criticism of ENI,s performance as operator by its partners, our contacts have never admitted to any intra-consortium friction.) ENI has an even bigger stake in the Karachaganak project in northwest Kazakhstan, where it is co-operator along with British Gas.

¶4. (C) Although our ENI contacts tend to downplay ongoing problems with both the Kashagan and Karachaganak projects, they have told us that ENI,s relationship with the Kazakhstani government has hit occasional rough spots. These include a contract dispute that our contacts tell us was resolved only when President Nazarbayev intervened to confirm the sanctity of existing contracts (including the production sharing agreements ENI has with the GOK). ENI has characterized the mid-May decision by ENI and most of its consortium partners to buy out BG,s stake in the Kashagan project (rather than allow the entrance of two Chinese companies into the consortium) as a normal business decision. Our contacts are tight lipped about more recent problems with the GOK (such as obtaining GOK approval of the Kashagan development plan, as well as the revocation of the consortium's zero-rate VAT status). ENI has publicly acknowledged the delay in getting the development plan approved. However, our contacts tell us that, for now, the company is not unduly concerned.

¶5. (SBU) In contrast to its high hopes for its operations in Kazakhstan, ENI is unenthusiastic about Azerbaijan, exemplified by the late 2002 decision to have LukAgip (its joint venture with Russia,s Lukoil) pull its ten percent stake out of the Shakh Deniz onshore gas project. ENI told us that decision rested on a number of factors: disappointing exploration results, an excess of gas in the region, lack of interest strategically (especially given its heavy investment in Kazakhstan), and, tellingly, "problems in the consortium." ENI was surprised by reports in late 2002 that LukAgip might be reconsidering the decision to pull out, noting their earlier decision had not changed. The company apparently remains committed to its five-percent stake in the Baku-Tbilisi-Ceyhan (BTC) oil pipeline.

Turkey, Greece and Gas to Europe - ENI Cautious
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¶6. (SBU) The completion and inauguration of the Blue Stream

gas pipeline across the Black Sea from Russia to Turkey is, like the Kashagan project, a point of pride among ENI executives. ENI,s enthusiasm for Blue Stream (despite the softened Turkish gas market) is not matched by that for the potential project to transit gas through Greece en route to the rest of Western Europe. ENI tells us its continued reluctance is owed to many factors. Italy,s energy liberalization law would inhibit it from buying or controlling such gas, forcing it to seek a long-term contract to export gas onward from Italy. Moreover, the gas is not needed in the less industrialized area of southern Italy where it would enter the country. Most tellingly, ENI is already committed to importing gas from Algeria (via Tunisia to Sicily) and, eventually, from Libya. ENI does not believe gas shipped from the Caspian would be competitive with North African imports. (Comment: Italian gas regulatory authorities are much more enthusiastic about bringing Caspian gas to Italy than is ENI; they are not concerned about the "oversupply" problem noted in para 7. Authorities see ENI's stance simply as part of the company's effort to maintain its continued dominance in the domestic Italian market. End comment.)

¶7. (SBU) During an Italy-Algeria energy ministerial meeting in April to promote a potential Algerian-Sardinian gas pipeline project, ENI CEO Vittorio Mincato dampened an otherwise enthusiastic conference by criticizing the proposed pipeline for its potential contribution towards what he views as a serious oversupply of gas into Italy. (Italian gas consumption fell in 2002 from 2001, the first such decline in decades.) Mincato admitted that the competing Libya-Sicily pipeline that ENI is constructing, planned during a more economically propitious time, was bound to aggravate the problem as well (Mincato acidly noted that the Libya pipeline will benefit ENI,s competitors by providing them with access to new gas supplies). Not surprisingly, ENI is not one of the Italian participants in the Algeria-Sardinia pipeline feasibility study (which does include ENI competitors Edison and ENEL). Ever the astute businessman, however, Mincato said that Saipem, ENI,s offshore construction company, could be interested in participating in the pipeline's construction.

Iran and Libya - Continued Strong Presence Foreseen
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¶8. (SBU) ENI,s interest in both Iran and Libya continues to be strong. While we are unaware of any new ENI investments in either country that might raise ILSA concerns, the company appears to be banking on future positive results from its ongoing activity. Pointing to its long history in both countries, predating Ghaddafi as well as the Iranian revolution, ENI emphasizes that addressing each nation over the long term is essential.

¶9. (SBU) ENI executives are more sanguine about Libya these days than Iran. The long planned Libya-Sicily gas pipeline is now entering an engineering and pre-construction phase, with a late 2004 completion date still foreseen. The Wafa natural gas field, being jointly developed by ENI with the Libyan National Oil Company, is expected to begin production at the same time to feed into the new pipeline. ENI,s acquisition of Lasmo led to its current position as operator of the Elephant oil field, where it holds a 33 percent stake - production is expected to begin later this year. Our ENI contacts say the company works well with Libyan energy entities. Generally positive trade exchanges between Italy and Libya (example - GOI Trade Vice Minister Adolfo Urso led a delegation to Libya April 7-8) provide an encouraging atmosphere for ENI,s activity there.

¶10. (SBU) ENI is more concerned about near-term developments in Iran, where the uncertain political situation of recent years heightens risk to the company,s operations. Nevertheless, ENI,s history of riding out the Iranian Revolution leaves it optimistic it can weather the current situation. In any case our contacts are hopeful that Iran will evolve into a more moderate regime, rather than undergo another revolution. ENI,s multibillion-dollar stakes in four major projects in Iran (including the Darkhovin oil field, the first onshore project to be developed by a foreign company since the Iranian revolution) are indicative of ENI,s commitment there, despite the risks.

¶11. (C) In discussing ENI,s operations in Iran and Libya, Embassy consistently reminds company executives of the

provisions of the Iran and Libya Sanctions Act. In a recent meeting, Ecmin reminded CEO Poli that the U.S. remains opposed to investment in both Libya and Iran. While the U.S. welcomes positive changes in Libya,s behavior, but it must still comply with all aspects of the UNSC resolutions related to the Lockerbie bombing (including admission of

responsibility and compensation). Ecmin also underscored the lack of positive developments in Iran, which continues to develop WMD, violate the human rights of its citizens, and support terrorism.

¶12. (SBU) ENI is closely watching developments in Iraq, and appears to be counting on the GOI,s support of the U.S.-led war to give the company a role in the reconstruction and modernization of the country's energy sector. ENI contacts have emphasized to us the company,s long history in Iraq (from the mid 1950s to the 1980s) and their broad experience in all aspects of petroleum exploration, production and engineering. ENI has told us the company is particularly interested in having Italian representation on the petroleum advisory committee being led by Philip Carroll.

European Expansion - Preparing for a Liberalized EU
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Market

¶13. (U) ENI is in the midst of an expansion drive, investing in energy companies outside of Italy, particularly elsewhere in Western Europe. Examples in the last two years include its acquisition of the UK oil firm Lasmo ($4.2 billion), its 50 percent stake in the Spanish gas company Fenosa (Euro 440 million), and its acquisition of the Norwegian assets of the Finnish oil and gas firm Fortum ($1.1 billion). In early 2003 ENI announced that it intended to become a major player in the European natural gas market by 2006, targeting especially Turkey, Germany and the Iberian Peninsula (with a goal of 44 BCM in European sales by 2006 compared to 20 BCM in 2002).

¶14. (SBU) Downstream, ENI foresees some increase in market share in selected European markets where it already enjoys supply advantages and brand awareness. Along with its selected overseas expansion efforts, our contacts tell us the company is carefully considering its operations worldwide, including possibly pulling out of some of the less promising countries in which it currently operates.

The Home Base - Declining Market, and Market Share
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¶15. (SBU) In the last decade ENI has been progressing from a parastatal holding company to a more integrated oil and gas company. Many corporate entities that had previously existed as separate companies (such as Agip Petroli, which oversees refining and marketing, and Agip Spa, which oversees exploration and production) have now been recast as divisions within ENI. There are a few significant exceptions that remain separate companies (Snamprogetti, Saipam), but our contacts envision these remaining entities being either reconstituted as ENI divisions or being sold off over the next few years.

¶16. (SBU) The GOI still controls 30 percent of ENI, though Prime Minister Berlusconi has hinted the GOI might sell a further share in the company. Although the GOI plays an important role in selecting ENI,s leadership, our contacts claim the company receives scant government pressure in terms of its decisions.

¶17. (SBU) ENI,s restructuring owes much to ongoing efforts both within Italy (the Letta Decree) and the EU to liberalize the energy market. Under the Letta Decree ENI must reduce its control of the natural gas market in Italy to 61 percent by 2010. Although the Italian Antitrust Authority ruled in late 2002 that ENI had violated the decree by exerting indirect control outside of Italy on gas imports to Italy, it imposed a token fine in recognition of ENI,s genuine efforts to stay within the limits of the liberalization regulations.

¶18. (SBU) ENI has told us that its recent decision to acquire all the shares of natural gas distributor Italgas (ENI formerly held 44% percent of Italgas shares) establishes a strong, integrated commercial arm that would help it form

alliances outside of Italy. Its eventual goal is to market gas exported from Italy, starting in approximately three years. Such exports will allow it to stay within the limits of the Letta Decree while optimizing markets for the (potential) oversupply of gas slated to arrive in Italy once the Libya-Sicily Green Stream pipeline begins operation.
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